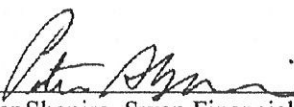


Swap Financial Group

Swap Financial Group, LLC
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South Orange, NJ 07079
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Attached hereto is the Loss Calculation Memorandum dated September 10, 2009 which contains a complete statement of my opinions as to the appropriate calculation of the Termination Amount owed to the Washington Tobacco Settlement Authority ("Washington TSA") under the Reserve Fund Agreement dated November 5, 2002, as amended. As set forth in my deposition dated December 13, 2013, the Termination Amount stated in the Loss Calculation Memorandum should be corrected to correlate to the scheduled maturity of the Reserve Fund Agreement in 2032. As a result, it is my opinion that the Termination Amount owed to Washington TSA is \$38,007,347, plus Section 7.7(b) losses in the amount of \$553,080, plus reasonable attorney and advisor fees. The basis for this opinion was further explored in my deposition dated December 13, 2013 and my answers in the deposition are incorporated herein.

Signed:


Peter Shapiro, Swap Financial

Dated:

12/16/2013



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MEMORANDUM

To: Bob Cook
Washington Tobacco Settlement Authority

From: Peter Shapiro, James Vergara

Concerning: Calculation of Loss for TSA's Reserve Fund Agreement with
Lehman Brothers Special Financing, Inc.

Date: September 10, 2009

Per your request, Swap Financial Group ("SFG") has prepared a Calculation of Loss for the Reserve Fund Agreement ("RFA") between the Tobacco Settlement Authority ("TSA") and Lehman Brothers Special Financing, Inc. ("LBSF"). Under the terms of the RFA, TSA, as the Burdened Party, has the right to calculate a Termination Amount "as reasonably determined in good faith by the Burdened Party, to be the Burdened Party's total losses and costs, or gains, in connection with a termination, including any loss of bargain, cost of funding, or, at the election of the Burdened Party but without duplication, any loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position..."

Under the terms of the RFA, TSA delivered to LBSF an amount equal to the "Scheduled Reserve Amount" or \$45,534,106.25 in exchange for Eligible Securities to deposit with the trustee to satisfy the liquidity reserve account requirement of its tobacco settlement securitization bonds. When the securities matured, TSA would again deliver the "Scheduled Reserve Amount" to LBSF to purchase new securities. In exchange for the periodic purchase of securities, LBSF provided TSA with a guaranteed rate of return on the "Scheduled Reserve Amount." Under the RFA, which had a scheduled termination date of May 30, 2042—the final scheduled Bond Payment Date per Exhibit A of the RFA—LBSF provided TSA with a guaranteed rate of return of 4.484%.

Lehman Brothers Holdings, Inc., the credit support provider for LBSF filed for bankruptcy on September 15, 2008 and LBSF ceased to perform under terms of the RFA. When the securities in the RFA matured, TSA was left to reinvest the proceeds in the open market, at significantly lower yields than the guaranteed rate of return originally offered by LBSF. LBSF itself filed for bankruptcy on October 3, 2008. For the purpose of this Calculation of Loss, SFG has looked at a valuation on March 25, 2009, the date that LBSF rejected the RFA between itself and TSA.

In order to calculate TSA's Loss, we began by analyzing the RFA cash flows. Under the RFA, Lehman guaranteed a fixed rate of return for TSA's Reserve Fund, to be realized in the form of the discount on the securities that LBSF agreed to deliver to the trustee on a periodic basis. The scheduled term of the RFA extended through May 30, 2042, though

TSA Reserve Fund Agreement – Calculation of Loss

September 10, 2009

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the Agreement could have been terminated prior to that date in the event that TSA's tobacco settlement securitization bonds are redeemed prior to their scheduled maturities, or if any of the parties to the RFA defaulted on their obligations. To value the cash flows under the RFA, the appropriate method is to use a similar interest rate swap in which one payer (LBSF) would pay a fixed rate of 4.484% and the other payer (TSA) would pay a floating rate.

The use of a LIBOR plus spread analysis with an interest rate swap to value agreements like the RFA is the broadly accepted market methodology. In the case of the RFA, the value of the floating leg is of great importance, since the value of the fixed leg is already known. The value of the floating leg should represent the value of the securities which are going to be delivered – short-term obligations (treasuries, agencies or commercial paper) with the highest ratings from Moody's (P-1) and Standard & Poor's (A-1+) – and also incorporate the ongoing credit risk of the RFA as an agreement in the first loss position of a municipal tobacco securitization. To complete the Calculation of Loss, SFG has also included the profit or spread component that would be charged by another provider to replace the RFA, if such a replacement agreement could be found.

Commercial Paper Spreads

The trading relationship between commercial paper and LIBOR has widened markedly over the past several months (though it has improved recently), as the overall credit markets have suffered during the financial crisis. This has been even more dramatic in the case of the structured commercial paper that was likely delivered under the RFA. Under normal, orderly market conditions, spreads for high-grade, structured commercial paper would typically be in a range of 0.20% to 0.30% over LIBOR. However, on the valuation date in question, the trading spreads were significantly greater, approximately 0.666% on March 25, 2009.

Charges for Municipal Tobacco Credit

Over the past twelve months, the value placed on the credit risk of municipal tobacco bonds has escalated sharply. This escalation has been greater than the increase in risk valuation that has occurred for most other forms of credit-based fixed income assets during the current financial crisis. TSA's 6 5/8% bonds of June 1, 2032 demonstrated this escalation dramatically, with market yields rocketing upward from 5.75% on March 26, 2008 to over 12% in December 2008. The bonds are currently trading at yields in excess of 10%. As a point of comparison, over the same time period (March to December 2008), yields on long-term treasury bonds declined by over 200 basis points.

In order to assess a proper credit charge for the RFA, we looked at the trading levels of TSA's bonds on the valuation date and compared it to a benchmark municipal index. On March 25, 2009, the bonds traded at a yield of 10.000%, which represents a spread of 4.290% over the Bloomberg 30-Year General Purpose Revenue Bond Index (A-Rated).

Profit Component

Lastly, our analysis takes into account the profit or spread component that would be included in any replacement investment if TSA were to replace the economic bargain

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afforded to it by the RFA. Given the challenging nature of the municipal tobacco credit, as well as the widening of bid-offer spreads in the fixed income markets in general, and in the municipal derivatives market in specific, we would expect a dealer to charge a profit component on the order of 0.25% to provide a replacement RFA, if such an agreement could even be replicated.

Calculation of Loss

In the table below, we summarize the various components that would be included in calculating the floating rate for the RFA, which would be incorporated into the Calculation of TSA's Loss.

<i>Date</i>	<i>CP Spread</i>	<i>Credit Spread</i>	<i>Profit</i>	<i>Total</i>
March 25, 2009	0.666%	(4.290%)	(0.25%)	(3.874%)

Using the spreads to LIBOR described above, SFG arrived at Loss values of \$46,437,610 for the March 25 valuation date in TSA's favor. Please note that a significant part of this difference is attributable to the rate environment on the valuation date, in addition to the spread assumptions. Illustratively, the 30-year Treasury Bond yield on March 25, 2009 was 3.742% while the 30-year LIBOR swap 3.433%. These yields are significantly lower than historical averages. The lower yield acts to increase TSA's loss.

Cost of Non-Performance

In addition to the Loss described above, TSA was also harmed by Lehman's non-performance under the RFA from December 1, 2008 (when securities were to be delivered) until March 25, 2009. Instead of the Guaranteed Rate on the RFA, TSA's reserve fund was invested in short-term Eligible Securities yielding a significantly lower rate. Instead of 4.484%, TSA's reserve fund earned 1.1874%, 0.64%, 0.48% and 0.20% for the months of December 2008 and January, February and March 2009, respectively. TSA's reserve fund should have earned \$646,553.95 from December 1, 2008 until March 25, 2009 instead of the \$93,473.93 that was actually earned. The difference of \$553,080.02 is therefore added the Loss amount above of \$46,437,610 for a total Loss of \$46,990,690.02.

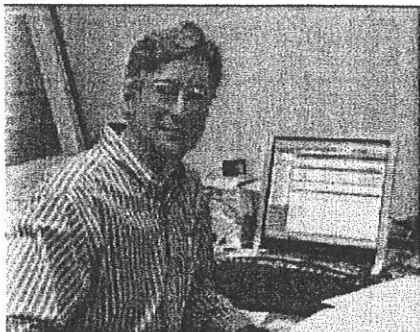
SFG has based its assumptions on market data available to us and our own experience in valuing agreements similar to the RFA.

Swap Financial Group, LLC

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Swap Financial Group

The leading independent swap advisor



Peter Shapiro

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Title:

Managing Director

Role:

Primary contact. Day-to-day project management, strategic advice, transactional analysis, documentation negotiation.

Relevant Experience:

20 years experience as a senior financial markets professional in the areas of public finance and financial derivative products. After more than a decade of governmental service, joined Citibank as an investment banker in the public finance area; became head of public finance, and shifted the business to focus exclusively on tax-exempt derivative products. Supervised first tender option bond program. Began structuring tax-exempt swaps, caps, floors and collars early in market's history, prior to establishment of the SIFMA/BMA Index. At Euro Brokers, headed up tax-exempt and end-user activities for the firm; built successful program for issuers to access swap market through competitive bidding on complex derivative structures that previously had been done only by negotiation. Founded Swap Financial Group in 1998. Handles the firm's senior client relationships, including major state agencies.

Education:

Swap Financial Group, LLC

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Harvard University, A.B. 1974 cum laude; Harvard Kennedy School of Government, State and Local Government Executives Program, 1979.

Work:

Managing Director, Swap Financial Group, 1998 - present; Senior Vice President, Euro Brokers, 1993 - 1997; Vice President and Department Head, Citibank, 1987 - 1993; County Executive, Essex County, New Jersey, 1978 - 1986; State Legislator, New Jersey State Assembly, 1976-1978.

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